85-848

Supreme Court, U.S.
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NO_____

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1985

CHRISTO M. DRAGATSIS and

MARY J. DRAGATSIS Petitioners

v

COMMISSIONER OF INTERNAL REVENUE

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

CHRISTO M. DRAGATSIS

MARY J. DRAGATSIS

Petitioners

57 West Jefferson St

Joliet, Illinois 60431

815-723-3491

Appearing Pro se

QUESTION PRESENTED

Whether cash rebates received by a taxpayer constitute income when received under a doctrine of embezzlement alleged by the Commissioner of Internal Revenue.

The question has been considered by the Seventh Circuit Court of Appeals. The Appeals Court held that income was realized by the recipient, holding that the funds were embezzled and were properly considered income by the Commissioner of Internal Revenue.

LISTING OF THE PARTIES

The only Petitioners in this case are:

Christo M. Dragatsis and

Mary J. Dragatsis

Petitioners

The only Respondent in this case is:

Commissioner of Internal Revenue

Respondent

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CHRISTO M.DRAGATSIS

MARY J. DRAGATSIS Petitioners

v

COMMISSIONER OF INTERNAL REVENUE

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to the order and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding August 20,1985.

OPINION BELOW

The opinion of the Court of Appeals for the Seventh Circuit entered August 20,1985 reported in an unpublished opinion appears in Appendix A hereto.

STATEMENT OF JURISDICTION

The Judgement of the Court of Appeals was entered on August 20,1985. The jurisdiction of this Court is invoked under Section 7282 of the Internal Revenue Code as provided in Section 1254 of Title 28 of The United States Code.

STATUTORY PROVISION INVOLVED

The Statutory provision involved is the section of the Internal Revenue Code that defines taxable income. The definition contained in the Internal Revenue Code, Section 61 Gross Income as defined, is as follows:

(a)"General definition except as otherwise provided in this sub-title, gross income means all income from whatever source derived, including all(but not limited to) the following items"

(end quote)

The definition of income contained in the Internal Revenue Code and as supported by Court cases includes embezzled funds.

STATEMENT OF THE CASE

The Petitioners filed petitions in the United States Tax Court for the year 1972 and 1974 as provided in Section 7442 of the Internal Revenue Code. The paramount issue in both years was the taxability of rebates received by the Petitioner from subcontractors that were working for the Petitioner. Matters before the Court for those years were resolved except the issue:

Did rebate amounts constitute income within the meaning of Internal Revenue Code section 61(a) to the Petitioner when received under a doctrine of embezzlement charged by the Commissioner of Internal Revenue.?

The Respondent in this case alleges that the rebates received were income to the Petitioner because Petitioner embezzled the funds from the partnership.

Petitioner contends that no embezzlement occurred. There was no evidence presented to indicate that these funds were the property of the partnership until Petitioner turned them over to the partnership. The rebate arrangement was between Petitioner and the subcontractors not between the partnership and the sub contractors.

THE CIRCUMSTANCES OF THE TRANSACTION

Petitioner and two partners decided to build a shopping center. Via oral agreement they contributed nominal capital, purchased the land,obtained a construction loan for the total cost of the project,and began construction.Petitioner acted as general contractor and experienced control of the project. Petitioner dealt solely with the subcontractors and personally signed all contracts for work to be performed on the shopping center. Inflated invoices were obtained from some of the contractors for work performed. These invoices were then presented to the bank for an advance on the contruction loan the partners had obtained. Full invoice amount was paid to the subcontractors.

The contractors would then repay the difference between the actual value of the work performed and the inflated invoice to the Petitioner.

Petitioner followed this practice in the years 1972 and a portion of the year 1974. Late in 1974 ,this practice was discovered by Commissioner of Internal Revenue during the course of an audit on Petitioner.Respondent advised Petitioner's partners of the rebates. Respondent questioned the Petitioner about the rebates and received ambiguous answers. Respondent questioned the partners regarding the rebates who advised they knew nothing of the transaction. At this point Respondent determined an embezzlement had taken place and sought to tax the Petitioner on the rebated funds as embezzled. Petitioner contended the rebates were a return of loan proceeds and were not taxable. Petitioner maintained that

these rebates would ultimately be shared with the partners. The rebates were shared equally with the partners in the year 1977 when a written partner ship agreement was drafted, the shopping center was completed, and Petitioner was relieved as managing partner.

THE PROCEEDINGS BELOW

Petitioner appealed the Tax Court decision to the Seventh Circuit. Petitioner sought review of the embezzlement issue by the Court. Petitioner asked the Court to review the embezzlement in view of the facts that the partners were aware of the rebates in the year 1974. The Court stated that the partners did not consent to his possession of the funds. Further , the Court reiterated the embezzlement aspects of the case and stated that regardless of the knowledge of a consensual obligation to repay, the Petitioner would be entitled to a deduction in the year the embezzled funds were repaid.

Petitioner contends the Court's analysis of the case is accurate only

if the embezzlement of funds was established. Since the arrangements for the rebates was between the Petitioner and the subcontractors ,a point held by the Tax Court, there was no claim by the partners to the rebates at that point. Further, Petitioner contends that the loan aspects of the rebates comes from the Patitioner's obligation to repay the bank for the funds,not the partners.

Further,since Petitioner was liable to the bank for the funds he allegedly embezzled , he had a consensual obligation to repay the loan funds to the bank.

REASONS FOR GRANTING THE WRIT

This petition for a writ of certiorari should be granted so that this Court may resolve the issue of whether income results in every case of an unauthorized withdrawal of a taxpayer were the Government alleges an embezzlement. Resolution of this question is important since embezzlement stands of one of the few crimes ,if not the only crime, that an individual can be convicted of without being charged with the crime or tried in a Court of Law.

Two different circuits have reached conflicting results when posed with the question of the non-typical embezzlement. Embezzlement consists of more than merely possessing property that is not held under an absolute claim of right.

The Court of Appeals for the Second Circuit held that unauthorized withdrawals by a convicted embezzler were not income to him, Gilbert v Commissioner of Internal Revenue 552 Fed (2d) 478.39 AFTR 2nd 77-1225 (CA 2-1977).

The Court of Appeals for the Second Circuit applied a criteria for embezzlement to the case. The Court analyzed, based on the circumstances of the case, what constituted an embezzlement.

It is Petitioners contention that the Seventh Circuit Court of Appeals in this case failed to address the issue of embezzlement in conjunction with the taxability of the funds included in income by the Respondent as the Second Circuit did in the Gilbert v Commissioner case.

THE WRIT SHOULD ALLOWED TO DETERMINE IF INCOME IS REALIZED IN EVERY CASE WHEN THE GOVERNMENT RAISES THE ISSUE OF EMBEZZLEMENT

It is inconceivable that income results in every transaction that the Commissioner of Internal Revenue labels as embezzlement. The criminal act of embezzlement results in income to the embezzler. This Court must address the issue of the authority of the Commissioner of Internal Revenue to build an embezzlement case against a taxpayer as opposed to his authority to tax the income that results from an embezzlement.

The case at hand is riddled with the theme of"embezzlement"and "criminal" activity. This is a civil case. Both the Tax Court and the Court of Appeals reiterate the criminal act and embezzlement theory. In the simplest form

the petitioner arranged for subcontractors ,with whom he was contracting , to rebate to the Petitioner excess charges contained in some of the billings for work performed.There is no basis in the tax law requiring the Petitioner to immediately turn this rebated money over to the partnership to avoid taxability. The substance of the transaction determines it's taxability. Petitioner's lack of sharing at the point of receipt does not constitute embezzlement. It was the Respondents choice to tax the money as embezzled funds. If these rebated funds were income and they belonged to the partnership ,they should have been included in the partnerships income for the years involved and then considered embezzled by the Petitioner and then included in his income.

This would have applied the taxability of the rebates in a consistant manner and prohibited the partners from treating the subsequent sharing of the rebates as a nontaxable withdrawal of funds from the partnership to which the Petitioner paid the rebated money. In this case the rebates were held taxable by reason of their embezzlement. This point is substantiated by the Commissioner's allowance of a tax deduction in the year the funds were turned over to the partnership, as is provided by law in an embezzlemnt case, by the Petitioner. If Respondent considers the rebates as kickbacks and taxable, their nature would be illegal and the partners would have no right to share in an illegal contract.

Petitioner contends that if it were not for the embezzlement theme used by

the Respondent in this case the funds would not have been considered income in this case.

THERE EXISTS A CONFLICT BETWEEN THE CIRCUITS AS TO THE TAXABILITY OF FUNDS RECEIVED UNDER ABNORMAL EMBEZZLEMENT CIRCUMSTANCES

The Court of Appeals for the Second Circuit held that the unauthorized withdrawels by a convicted embezzler was not income to him, In Gilbert V Commissioner of Internal Revenue 552 Fed (2d) 478.39 AFTR 2nd 77-1225(CA 2-1977).

The Court of Appeals for the Seventh Circuit in this case,opinion not published, found that income,embezzlement and criminal activity existed in a transaction where a managing partner received cash rebates from contractors working for him even though these rebates were split among the partners.

It is not the intent of the Petitioner in this case to propose that every case of embezzlement should be brought before the Supreme Court. It is the contention of the Petitioner that the case at hand could not be farther from an embezzlement case . The guise of an embezzlement and criminal activity raised by the Government in this case to attain taxability of a transaction is a travesty of justice.

In the Second Circuits determination of taxability of funds embezzled , a criteria of embezzlement was applied. by the Court. Intent to abscond with funds, probability of detection, equity in the transaction, ability to repay and authority to apply the funds were all considered to determine if an embezzlement had occurred.

The Seventh Circuit ignored all the above considerations with affirmation of the Tax Court's decision based on criminal and embezzlement activity.

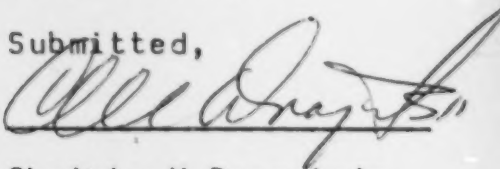
CONCLUSION

For the foregoing reasons ,a writ of certiorari should issue to review the judgement and opinion of the Seventh Circuit.

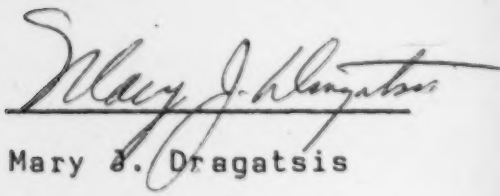
Dated November 14,1985

Respectfully

Submitted,



Christo M Dragatsis



Mary J. Dragatsis

57 West Jefferson St

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(815) 723-3491

Petitioners Appear

Pro se

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

CHICAGO,ILLINOIS 60604

August 20,1985

Before

HON JESSE E. ESCHBACH Circuit Judge

HON RICHARD POSNER Circuit Judge

HON JOHN L. COFFEY Circuit Judge

CHRISTO M.DRAGATSIS and

MARY J. DRAGATSIS Petitioners Appellants

v No. 84-2935 842936

COMMISSIONER OF INTERNAL REVENUE

Respomdent-Appellee

ORDER

Petitioners Christo and Mary Dragatsis appeal from a judgement of the Tax Court determining deficiencies for the 1972 and 1974 tax years. We find the thorough and well reasoned Tax Court memorandum opinion Dragatsis V Commissioner ,1984 TCM(P-H) 84,122(1984),dispositive of petitioner's

claims and we affirm and adopt it. We nonetheless expand upon the Tax Court's analysis in one respect. Petitioner's primary assertion on appeal is that once Christo's business partners were informed in 1974 that he was embezzling loan funds from the partnership ,the funds embezzled no longer constituted income for tax purposes. Rather ,his partners' awareness was a consensual recognition of an obligation to repay the funds into a loan from the partnership.

This argument fails for two reasons. First, the Tax Court found that Christo's partners did not consent to his possession of the funds. We will only set aside such findings of fact when it is clearly erroneous. Falkhoff V Commissioner ,604 F. 2d 1049 n.6 (7th Circuit 1979)In this case we decline to find a consensual recognition in view

of the overwhelming evidence to the contrary. Second, even if there was a consensual recognition in late 1974 an agreement to repay or any recognition of an obligation to repay the embezzled funds has no tax consequences regardless of whether such an agreement was made in the same year that the funds were embezzled. Rather a taxpayer will be entitled to a deduction in the year in which the funds are actually repaid. Rappaport v United States 583 F.2d 298, 302 (7th Circuit 1978):Quinn v Commissioner,524 F. 2d 617,625 (7th Cir,1975.)

The judgement of the Tax Court is Affirmed.

Section 61 (a) Internal Revenue Code.

(a)"General definition except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including all (but not limited to the following items"

(1) Compensation for services,including fees,commissions,fringe benefits, and similar items.

(2) Gross income derived from business

(3) Gains derived from dealing in property

(4) Interest

(5) Rents

(6) Royalties

(7) Dividends

(8) Alimony and seperate maintenance payments

(9) Annuities

(10) Income from life insurance and endowment contracts

(11) Pensions

(12) Income from discharge of indebtedness

(13) Distributive share of partnership gross income

(14) income in respect of a decedent:and

(15) Income from an interest in an estate or trust.

PROOF OF SERVICE

I Christo Dragatsis state under oath that I have delivered a required number of copies of the foregoing petition to the Respondent at the following address via certified mail:

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Michael L Paup

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Washington , D.C. 20530

Signed

Christo Dragatsis